Financial review

Results summary

International Financial Reporting Standards (IFRS) basis results*

Statutory IFRS basis results

	2011	2010
Profit after tax attributable to equity holders of the Company	£1,490m	£1,431m
Basic earnings per share	58.8p	56.7p
Shareholders' equity, excluding non-controlling interests	£9.1bn	£8.0bn

Supplementary IFRS basis information

	2011 £m	2010 £m
Operating profit based on longer-term investment returns*	2,070	1,941
Short-term fluctuations in investment returns on shareholder-backed business	(148)	(123)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	21	(10)
Costs of terminated AIA transaction	–	(377)
Gain on dilution of Group holdings	–	30
Profit before tax attributable to shareholders	1,943	1,461
Operating earnings per share* (reflecting operating profit based on longer-term investment returns after related tax and non-controlling interests)(i)	63.9p	62.0p

European Embedded Value (EEV) Basis Results*

	2011 £m	2010 £m
Asian operations	1,839	1,518
US operations	1,455	1,480
UK operations:		
UK insurance operations	893	982
M&G	357	284
Other income and expenditure	(536)	(494)
RPI to CPI inflation measure change on defined benefit pension schemes	45	–
Restructuring and Solvency II implementation costs	(75)	(74)
Operating profit based on longer-term investment returns*	3,978	3,696
Short-term fluctuations in investment returns	(907)	(30)
Mark to market value movements on core borrowings	(14)	(164)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	23	(11)
Effect of changes in economic assumptions	(158)	(10)
Costs of terminated AIA transaction	–	(377)
Gain on dilution of Group holdings	–	3
Profit before tax (including actual investment returns)	2,922	3,107
Operating earnings per share* (reflecting operating profit based on longer-term investment returns after related tax and non-controlling interests)(i)	115.7p	106.9p
Shareholders' equity, excluding non-controlling interests	19.6bn	18.2bn

	2011	2010
Dividends per share declared and paid in reporting period	25.19p	20.17p
Dividends per share relating to reporting period	25.19p	23.85p
Funds under management	£351bn	£340bn
Insurance Groups Directive capital surplus (as adjusted)*	£4.0bn	£4.3bn

*See basis of preparation on following page.

Note

(i) Operating earnings per share reflects operating profit based on longer-term investment returns after related tax and non-controlling interests but excludes in 2010 an exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities.

* Basis of preparation

Results bases

The basis of preparation of the statutory IFRS basis results and supplementary IFRS basis information is consistent with that applied for the full year 2010 results and financial statements.

The EEV basis results have been prepared in accordance with the European Embedded Value Principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV disclosures published in October 2005. Life insurance products are, by their nature, long-term and the profit on this business is generated over a significant number of years. Accounting under IFRS alone does not, in Prudential's opinion, fully reflect the value of future profit streams. Prudential considers that embedded value reporting provides investors with a measure of the future profit streams of the Group's in-force long-term businesses and is a valuable supplement to statutory accounts. There has been no change to the basis of presentation of the EEV results from the 2010 results and financial statements.

Exchange translation – Actual Exchange Rate (AER) and Constant Exchange Rate (CER)

The comparative results have been prepared using previously reported exchange rates (AER basis) except where otherwise stated. In particular results on a constant exchange rate (CER) basis are shown for the analysis of IFRS and EEV operating profit based on longer-term investment returns.

Operating profit based on longer-term investment returns

Consistent with previous reporting practice, the Group provides supplementary analysis of IFRS profit before tax attributable to shareholders and analyses its EEV basis results, so as to distinguish operating profit based on longer-term investment returns from other elements of total profit. On both the IFRS and EEV bases, operating earnings per share are calculated using operating profits based on longer-term investment returns, after related tax and non-controlling interests.

These profits exclude short-term fluctuations in investment returns and the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes. The operating profit based on longer-term investment returns for 2010 also excludes the costs associated with the terminated AIA transaction and the gain arising upon the dilution of the Group's holding in PruHealth.

Under the EEV basis, where additional profit and loss effects arise, operating profit based on longer-term investment returns also excludes the mark to market value movements on core borrowings and the effect of changes in economic assumptions.

After adjusting for related tax and non-controlling interests, the amounts excluded from operating profit based on longer-term investment returns are included in the calculation of basic earnings per share, based on total profit attributable to the company's equity holders.

Insurance Groups Directive capital surplus (as adjusted)

The surpluses shown for 2011, which is estimated, and 2010 are before allowing for the final dividends for 2011 and 2010 respectively.

Accounting policy change to be applied in 2012

In October 2010, the Emerging Issues Task Force of the US Financial Accounting Standards Board issued new guidance on accounting for Deferred Acquisition Costs (DAC), effective for reporting periods commencing after 15 December 2011. These proposals restrict the acquisition costs that can be deferred to future periods to those costs that are directly incremental to acquiring a new contract. Although Prudential does not report in accordance with US GAAP, under the accounting policies applied in accordance with IFRS 4, US GAAP is used to measure the insurance assets and liabilities of Jackson and certain of Prudential's Asian operations. Prudential has therefore chosen, as an accounting improvement, to adopt from 1 January 2012 the new US GAAP DAC proposals for these entities. This change will first be applied in the 2012 half year financial report and there is no impact on the results included in this announcement for 2011 and 2010. However, on adoption of the new policy, which will be applied retrospectively, the 2011 IFRS operating profit based on longer-term investment returns will be altered from £2,070 million to £2,027 million, profit before tax attributable to shareholders will be altered from £1,943 million to £1,828 million, and shareholders' funds at 31 December 2011 will be altered from £9,117 million to £8,564 million. Further details, together with the equivalent impacts on the 2010 results and shareholders' funds, can be found in note III(a) of the Additional unaudited financial information. The change of policy has no effect on the regulatory capital position of the Group or on the overall EEV basis results, other than the presentational analysis of EEV shareholders' funds between the component representing IFRS basis shareholders' equity and the component representing additional shareholders' retained profit recognised on the EEV basis.

Financial review

IFRS results

IFRS basis operating profit based on longer-term investment returns

		AER		CER	
	2011 £m	2010 £m	Change %	2010 £m	Change %
Insurance business					
Long-term business:					
Asia	709	536	32	533	33
US	694	833	(17)	803	(14)
UK	683	673	1	673	1
Development expenses	(5)	(4)	25	(4)	25
Long-term business profit	2,081	2,038	2	2,005	4
UK general insurance commission	40	46	(13)	46	(13)
Asset management business:					
M&G (including Prudential Capital)	357	284	26	284	26
Eastspring Investments	80	72	11	73	10
Curian	6	1	500	1	500
US broker-dealer and asset management	18	21	(14)	20	(10)
	2,582	2,462	5	2,429	6
Other income and expenditure	(483)	(450)	7	(449)	8
RPI to CPI inflation measure change on defined benefit pension schemes[i]	42	–	n/a	–	n/a
Solvency II implementation costs	(55)	(45)	22	(45)	22
Restructuring costs	(16)	(26)	(38)	(26)	(38)
Total IFRS basis operating profit based on longer-term investment returns	2,070	1,941	7	1,909	8

Note

(i) During 2011 the Group altered its assumptions for future statutory increases to pension payments for its UK defined benefit pension schemes. This reflects the UK government's decision to change the basis of indexation from RPI to CPI.

In 2011, the Group's IFRS operating profit based on longer-term investment returns was £2,070 million, an increase of 7 per cent from 2010.

In Asia, IFRS operating profit for long-term business increased by 32 per cent from £536 million in 2010 to £709 million in 2011. Profits from in-force business grew by 29 per cent between the two periods from £593 million to £763 million, reflecting the continued growth of the business in the region. New business strain of £54 million (2010: £56 million[1]) was lower despite higher sales due to favourable product and country mix.

Hong Kong, Indonesia, Singapore and Malaysia, Prudential's largest markets in Asia, continue to see profits grow strongly, with operating profits from long-term business[2] up 27 per cent from £434 million in 2010 to £552 million in 2011. The growth in Indonesia operating profit[2] has been particularly strong, up 35 per cent from £157 million to £212 million, reflecting the organic growth of that business over recent years. Hong Kong's operating profit[2] increased 35 per cent to £69 million (2010: £51 million), reflecting the continued growth of the portfolio. Singapore increased by 29 per cent to £167 million[2] (2010: £129 million) and Malaysia increased by 7 per cent from £97 million to £104 million[2]. Other territories contributed operating profits of £119 million before non-recurring items (2010: £83 million), an increase of 43 per cent, and have all made positive contributions to this metric for the first time.

Notes

1 Excludes Japan which ceased writing new business in 2010. New business strain in 2010 was £1 million.

2 Before non-recurring items.

The US long-term business operating profit decreased by 17 per cent from £833 million in 2010 to £694 million in 2011 and is, after charging £232 million (2010: £11 million) of accelerated DAC amortisation, as anticipated. This charge, which is not expected to recur, arises as a result of market movements and their interaction with the mean reversion methodology. It has the effect of masking an underlying improvement in the earnings of the US business, reflecting higher fees from variable annuity business following the growth of separate account balances in recent years. The benefit of higher fees is partially offset by administration expenses which have also increased broadly in line with the scale of business.

In Prudential's UK business, total IFRS operating profit was slightly higher than the prior year at £723 million (2010: £719 million), with long-term business generating £683 million (2010: £673 million). The year-on-year comparisons are distorted by the effect of bulk annuity transactions which are infrequent and vary in size between financial periods. Our approach to these is very selective and we will only write this business when it meets our strict profitability criteria. Two such transactions were completed in 2011 contributing £23 million to IFRS profits, compared to one transaction in 2010 with an IFRS profit contribution of £63 million.

Life business in the UK (excluding the impact of the bulk annuity transactions), contributed operating profits of £660 million in 2011, 8 per cent higher than the £610 million generated in 2010. The contribution from with-profits business was lower at £293 million (2010: £310 million). Operating profit from non-profit annuity and other life business was £67 million higher at £367 million, reflecting higher annuity profits. Profit from UK general insurance commission were lower at £40 million (2010: £46 million) following the expected decline of the in-force policy numbers as the business matures.

Total operating profit for 2011 from M&G and Prudential Capital was £357 million, an increase of 26 per cent from £284 million in 2010. This performance is driven by improved revenues reflecting the strong net inflows received in recent periods, with funds under management of £201 billion at 31 December 2011, compared with £198 billion at 31 December 2010, together with a continued focus on cost discipline which saw a three percentage point reduction in the cost/income ratio.

Eastspring Investments reported operating profits of £80 million, an increase of 11 per cent from the £72 million recognised in 2010. This improvement is driven both by increased operating revenues from higher average funds under management during 2011 and continued cost discipline resulting in a two percentage point improvement in the cost/income ratio.

The £33 million increase in the charge for other income and expenditure from £450 million in 2010 to £483 million in 2011 primarily reflects an increase in interest payable on core structural borrowings, following additional debt raised in January 2011 to repay debt in December 2011.

Following the UK government's decision to change the basis of indexation from RPI to CPI, the Group altered its assumptions for future statutory increases to pension payments for its UK-defined benefit pension schemes. This resulted in a one-off credit to operating profit of £42 million in 2011 and will not recur going forward.

A total of £55 million of Solvency II implementation costs were incurred in 2011 (2010: £45 million) as we move closer to the implementation of the new regime.

Financial review

IFRS basis results – analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver

	AER			AER			CER		
	2011			2010[iii]			2010		
	Operating profit £m	Average liability £m	Margin[i] bps	Operating profit £m	Average liability £m	Margin[i] bps	Operating profit £m	Average liability £m	Margin[i] bps
Spread income	1,065	57,417	185	1,013	53,894	188	988	53,056	186
Fee income	870	68,298	127	688	56,822	121	669	56,303	119
With-profits	331	93,056	36	342	89,693	38	342	90,060	38
Insurance margin	736			592			582		
Margin on revenues	1,425			1,212			1,211		
Expenses									
Acquisition costs[ii]	(1,783)	3,681	(48)%	(1,645)	3,492	(47)%	(1,612)	3,439	(47)%
Administration expenses	(1,043)	125,715	(83)	(924)	110,716	(83)	(910)	109,359	(83)
DAC adjustments	280			518			498		
Expected return on shareholder assets	200			242			237		
Operating profit based on longer-term investment returns	2,081			2,038			2,005		

Notes

(i) Margin represents the operating return earned in the period as a proportion of the relevant class of policyholder liabilities excluding unallocated surplus. For UK and Asia, opening and closing policyholder liabilities have been used to derive an average balance for the period, as this is seen as a good proxy for average balances throughout the year. Given the volatility in the year, the calculation of average liabilities has been refined for Jackson in two ways: (i) the average for both the general and separate account balances is now derived from month-end balances throughout the year as opposed to opening and closing balances only, and (ii) liabilities held in the general account for variable annuity living and death guaranteed benefits have been excluded from the calculation of the average, as no spread income is earned on these balances. The 2010 balances for Jackson have been amended for consistency, albeit impacts are minimal.

(ii) Acquisition cost ratio represents shareholder acquisition costs as a percentage of total APE (including £7 million of sales for Japan in 2010).

(iii) Following the reduction in 2010 of the Group's interest in the PruHealth and PruProtect businesses from 50 per cent to 25 per cent, the profits of these businesses have been shown as a single line in the insurance margin line consistent with associate accounting principles. 2010 has been amended in light of this change.

Spread income has increased by £52 million to £1,065 million, an increase of 5 per cent, broadly in line with the growth in average liabilities. The margin secured has fallen from 188 bps in 2010 to 185 bps in 2011, principally due to 2010 benefiting from higher bulk annuity sales. Spread income in the US has increased by £38 million, with 2011 continuing to benefit from transactions to more closely match asset and liability duration, as well as lower amounts credited to policyholders on fixed annuities.

Fee income has increased by £182 million to £870 million, driven by the 20 per cent increase in the Group's average unit-linked liabilities, which principally reflects the £7.0 billion net inflows into Jackson separate's accounts in 2011. The fee income margin has increased from 121 bps to 127 bps in 2011 as Jackson contributes a greater proportion to the total, where the fee margin is higher.

Insurance margin has increased by £144 million to £736 million in 2011, driven in part by the continuing growth in the in-force book in Asia, which has a relatively high proportion of risk-based products.

Margin on revenues principally comprises amounts deducted from premiums to cover acquisition costs and administration expenses. The margin has increased by £213 million from £1,212 million in 2010 to £1,425 million in 2011, with Asia accounting for £181 million of the increase. This principally reflects higher premium income.

Acquisition costs have increased in absolute terms to £1,783 million, broadly in line with the increased new business sales. Expressed as a percentage of new business APE, 2011 has seen a marginal increase from 47 per cent in 2010 to 48 per cent in 2011.

Administration expenses have also increased to £1,043 million, reflecting the growth of the business in the year, while the margin remains constant at 83 bps.

DAC adjustments are a net benefit to the result as the deferral of current years acquisition costs exceed the amortisation of previously deferred costs. This net benefit decreased by £238 million in 2011 relative to last year, primarily as a result of the acceleration of DAC amortisation in the US of £232 million. This represents the reversal of the benefit received in 2008 from the mean reversion formula, together with the impact of lower than assumed separate account returns in the year.

IFRS basis results – margin analysis of asset management pre-tax IFRS operating profit based on longer-term investment returns by driver

	2011 £m				
	M&G	Eastspring Investments	PruCap	US	Total
Operating income*	727	202	122	338	1,389
Operating profit based on longer-term investment returns	301	80	56	24	461
Average funds under management (FUM)†	£199.8bn	£51.1bn			
Margin based on operating income†	36bps	40bps			
Cost/income ratio‡	60%	62%			

	2010 £m				
	M&G	Eastspring Investments	PruCap	US	Total
Operating income*	632	191	88	229	1,140
Operating profit based on longer-term investment returns	246	72	38	22	378
Average funds under management (FUM)†	£186.5bn	£47.2bn			
Margin based on operating income†	34bps	40bps			
Cost/income ratio‡	63%	64%			

* Operating income is net of commissions and includes performance related fees.
† Margin represents operating income as a proportion of the funds under management (FUM). Opening and closing FUM have been used to derive the average.
‡ Cost/income ratio is calculated as, cost as a percentage of income excluding performance-related fees, and for M&G carried interest on private equity investments.

M&G's asset management fee margin increased from 34 bps in 2010 to 36 bps in 2011. This reflected a shift in funds under management mix towards external business which at 31 December 2011 represented 46 per cent of total funds under management (2010: 45 per cent). M&G continues to focus on cost control and the efficiencies created as the scale of the business grows. The benefit of this operational leverage is evident in the reduction in the cost/income ratio from 63 per cent in 2010 to 60 per cent in 2011.

At Eastspring Investments, fee margin has been maintained at 40 bps. The margin reflects higher retail margins arising from new administration fees for offshore funds and higher margins in Taiwan, offset by a decrease in institutional margins due to a shift in asset mix from higher margin equity funds, in favour of lower margin fixed income funds. Equity markets correction experienced in Asia and globally in 2011 has contributed to this asset mix shift. Continued focus on costs has seen cost/income ratio decrease from 64 per cent in 2010 to 62 per cent in 2011.

PruCap's operating profit increased during 2011, reflecting the ongoing active management of the portfolio in the period.

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IFRS basis profit after tax

	AER	
	2011 £m	2010 £m
Operating profit based on longer-term investment returns	2,070	1,941
Short-term fluctuations in investment returns:		
Insurance operations	(28)	(148)
Other operations	(120)	25
	(148)	(123)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	21	(10)
Costs of terminated AIA transaction	–	(377)
Gain on dilution of Group holdings	–	30
Profit before tax attributable to shareholders	1,943	1,461
Tax charge attributable to shareholders' profit[i]	(449)	(25)
Non-controlling interests	(4)	(5)
Profit for the year attributable to equity holders of the Company	1,490	1,431

Note
(i) In 2010, tax charge attributable to shareholders' profit includes a credit of £158 million which primarily relates to the impact of a settlement agreed with the UK authorities.

IFRS basis profit after tax

The total profit before tax attributable to shareholders was £1,943 million in 2011, compared with £1,461 million in 2010. The improvement reflects the increase in operating profit based on longer-term investment returns, and the fact that in 2010 the profit was reduced by the terminated AIA transaction costs of £377 million.

In calculating the IFRS operating profit, we use longer-term investment return assumptions rather than actual investment returns arising in the year. The difference between actual investment returns recorded in the income statement and longer-term returns is shown in the analysis of profits as short-term fluctuations in investment returns.

IFRS short-term fluctuations in investment returns

Short-term fluctuations in investment returns for our insurance operations comprise negative £92 million for Asia, negative £95 million for US operations and positive £159 million in the UK.

The negative short-term fluctuations of £92 million for our Asian operations in part reflects equity market falls in Taiwan and a partial reversal of unrealised gains recognised in prior years on the Group's investment in China Life Insurance Company of Taiwan.

Negative fluctuations of £95 million arising in our US operation comprise negative £183 million from short-term fluctuations offset by positive £88 million relating to Jackson's debt securities portfolio. These gains arise as a result of a high level of realised investment gains in 2011, following management's credit risk reduction programme.

The positive short-term fluctuations of £159 million for our UK operations principally reflect net valuation gains arising in the period on fixed income assets backing the capital of the shareholder-backed annuity business.

Short-term fluctuations for other operations were negative £120 million representing unrealised losses on investments, principally on centrally held swaps to manage foreign exchange and certain macroeconomic exposures of the Group.

Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes

The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes of positive £21 million mainly reflects favourable experience in the year in respect of the Scottish Amicable scheme combined with the impact of assumption changes, primarily from lower inflation and lower expected salary increases, applied to the liabilities of both the Scottish Amicable and M&G schemes.

Effective tax rates

The effective rate of tax on operating profit based on longer-term investment returns was 22 per cent (2010: 11 per cent). For 2010, adjusting the reported tax rate to exclude the exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities, the underlying tax rate operating profit was 19 per cent.

The effective rate of tax at the total IFRS profit level was 23 per cent (2010: 2 per cent). Adjusting the rate in 2010 to exclude the exceptional tax credit of £158 million gives an underlying tax rate at the total IFRS profit level of 13 per cent. In both 2011 and 2010, we have benefited from a reduction in the main UK corporate tax rate from 28 per cent to 26.5 per cent. In 2010, and to a lesser extent in 2011, we also benefited from utilising carried forward tax losses for which no deferred tax asset was previously established.

EEV results

EEV basis operating profit based on longer-term investment returns

		AER		CER	
	2011 £m	**2010** £m	**Change** %	**2010** £m	**Change** %
Insurance business					
Asia	1,764	1,450	22	1,438	23
US	1,431	1,458	(2)	1,406	2
UK	853	936	(9)	936	(9)
Development expenses	(5)	(4)	25	(4)	25
Long-term business profit	4,043	3,840	5	3,776	7
UK general insurance commission	40	46	(13)	46	(13)
Asset management business:					
M&G	357	284	26	284	26
Eastspring Investments	80	72	11	73	10
Curian	6	1	500	1	500
US broker-dealer and asset management	18	21	(14)	20	(10)
	4,544	4,264	7	4,200	8
Other income and expenditure	(536)	(494)	9	(493)	9
RPI to CPI inflation measure change on defined benefit pension schemes[(i)]	45	–	n/a	–	n/a
Solvency II implementation costs	(56)	(46)	22	(46)	22
Restructuring costs	(19)	(28)	(32)	(28)	(32)
Total EEV basis operating profit	3,978	3,696	8	3,633	9

Note
(i) During the first half of 2011 the Group altered its assumptions for future statutory increases to pension payments for its UK defined benefit pension schemes. This reflects the UK government's decision to change the basis of indexation from RPI to CPI.

In 2011, Prudential Group's total EEV basis operating profit based on longer-term investment returns was £3,978 million, an increase of 8 per cent from 2010.

Long-term business profit generated by the Group increased by 5 per cent to £4,043 million. This profit comprises:

- New business profit of £2,151 million (2010: £2,028 million[1]);
- In-force profit of £1,897 million (2010: £1,817 million); and
- Negative £5 million for other items including development expenses (2010: negative £5 million).

New business profit at £2,151 million was 6 per cent higher than last year, which compares with the equivalent increase in new business APE of 6 per cent. Group new business margin was unchanged at 58 per cent as pricing actions coupled with favourable changes in business mix fully mitigated the downward pressure on margins from the significant declines in long-term interest rates.

Strong new business margins continue to be recorded across the Group. The margin for the Asian business increased from 60 per cent to 65 per cent driven by a shift in country mix and the ongoing high mix of health and protection business. The reduction in the US new business profit margin was curtailed to a one percentage point decrease to 64 per cent despite the significant falls in 10-year Treasury yields, as management took strong pricing and business actions. The UK new business margin was lower than last year at 35 per cent (2010: 45 per cent). Comparisons here are distorted by our selective approach to bulk annuity sales. The retail margin (which excludes credit life and bulk annuities) fell from 35 per cent in 2010 to 32 per cent in 2011 due to lower sales of the higher margin annuity business.

Note
1 Excludes Japan which ceased writing new business in 2010.

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EEV basis operating profit based on longer-term investment returns continued

The contribution to operating profit from life in-force business increased by 4 per cent to £1,897 million. In-force profit comprises £1,447 million from the unwind of the discount on the opening embedded value and other expected returns (2010: £1,492 million) and £450 million from the effect of operating assumption changes, experience variances and other items (2010: £325 million). The unwind of discount and other expected returns is £45 million lower than 2010 with the growth in the business, being offset by the effect on this profit measure of lower interest rates. We estimate that the fall in long-term interest rates during 2011 adversely impacted the unwind and other expected returns by around £200 million.

In 2011, at £688 million (2010: £549 million), Asia was the highest contributor to the Group's life in-force profit for the first time. In Asia we have seen improvements in overall experience and operating assumption changes, with a positive impact for the year of £75 million (2010: negative £24 million). This positive trend primarily reflects favourable mortality and morbidity experience partially offset by the effect of strengthening partial withdrawals lapse assumptions in Malaysia following the review undertaken in 2011.

US life in-force profit was lower at £616 million (2010: £697 million). Jackson's focused approach to managing the in-force portfolio coupled with the benefits of scale, have enabled the business to outperform its expected return in both years, albeit to a lower extent in 2011. The contribution to profits from experience and operating assumption changes totalled £183 million in 2011, compared to £246 million last year. Within these amounts, swap transactions undertaken to more closely match the overall asset and liability duration in 2010 and 2011, contributed to spread gains of £152 million (2010: £158 million).

UK life in-force profit was also higher at £593 million (2010: £571 million). The reduction in 15-year gilt yields reduced the contribution from the unwind of the discount on the opening embedded value and return on net worth relative to last year by £65 million to £485 million. Disciplined management of the in-force book has enabled the business to outperform the expected returns, generating profits from experience and operating assumption changes of £108 million (2010: £21 million). Included in both years are the beneficial effects on future profits arising from the reduction in UK corporation taxes enacted in both years; in 2011 this amounted to £79 million, while in 2010 this amounted to £41 million.

Operating profit from the asset management business and other non-long-term businesses increased to £501 million, up 18 per cent from £424 million in 2010.

Other income and expenditure totalled a net expense of £536 million compared with £494 million in 2010. The £42 million increase principally reflects the higher interest payable on core structural borrowings on the US$550 million Tier 1 subordinated note issued in January, the proceeds of which were used to redeem the €500 million Tier 2 notes in December 2011.

EEV basis profit after tax and non-controlling interests

	AER 2011 £m	2010 £m
EEV basis operating profit based on longer-term investment returns	3,978	3,696
Short-term fluctuations in investment returns:		
Insurance operations	(787)	(55)
Other operations	(120)	25
	(907)	(30)
Mark to market value movements on core borrowings	(14)	(164)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	23	(11)
Effect of changes in economic assumptions	(158)	(10)
Costs of terminated AIA transaction	–	(377)
Gain on dilution of Group holdings	–	3
Profit before tax	2,922	3,107
Tax charge attributable to shareholders' profit[i]	(776)	(530)
Non-controlling interests	(4)	(4)
Profit after non-controlling interests	2,142	2,573

Note
(i) In 2010 tax charge attributable to shareholders' profit includes a credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities.

EEV basis profit after tax and non-controlling interests

Short-term fluctuations in investment returns

EEV operating profit is based on longer-term investment return assumptions rather than actual investment returns achieved. Short-term fluctuations in investment returns represent the difference between the actual investment return and those assumed in arriving at the reported operating profit.

Short-term fluctuations in investment returns for insurance operations of negative £787 million comprise negative £155 million for Asia, negative £491 million for our US operations and negative £141 million in the UK.

For our Asian business, short-term fluctuations of negative £155 million (2010: positive £287 million) reflects the effect on future fee income of the lower than assumed equity market returns in 2011, partially offset by valuation gains on bonds backing shareholder capital arising from the fall in interest rates.

In our US business, short-term fluctuations in investment returns were negative £491 million (2010: negative £678 million), principally reflecting the effect on fee income of the actual separate account return in 2011 of negative 0.5 per cent being lower than the longer term expected level of 5.4 per cent on projected future fees.

For our UK business, the short-term fluctuations in investment returns were negative £141 million (2010: positive £336 million). This reflects the actual return on the with-profits fund in 2011 of 3.2 per cent being lower than the longer-term assumed rate of 5.1 per cent, partly offset by higher than expected returns on the bonds backing the capital of the shareholder annuity business, following the fall in yields in 2011.

Mark to market movement on core borrowings

The mark to market movement on core borrowings was a negative £14 million in 2011, lower than the negative £164 million reported in 2010 when there was a more significant narrowing of credit spreads as the 2008 market dislocation unwound.

Financial review

EEV basis profit after tax and non-controlling interests continued

Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes

The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes on the EEV basis comprises the IFRS charge attributable to shareholders, and the shareholders' share of movements in the scheme assets and liabilities attributable to the PAC with-profits fund. On the EEV basis there was a gain of £23 million (2010: charge of £11 million) mainly reflecting favourable experience in the year in respect of the Scottish Amicable scheme combined with the impact of assumption changes, primarily from lower inflation and expected salary increases, applied to the liabilities of both the Scottish Amicable and M&G schemes.

Effect of changes in economic assumptions

The effect of changes in economic assumptions of negative £158 million, comprises positive £279 million for Asia, negative £144 million for the US and negative £293 million for the UK.

The Asia and UK effect principally reflects the effect on economic profits of the reduction in long-term yields and the associated decrease in the risk discount rates. This effect is positive in Asia given the predominance of health and protection while in the UK this effect is negative as the majority of future profits relate to with-profits business.

In our US business, the reduction in long-term yields and the associated decrease in risk discount rates has a positive effect on future fixed annuity spread profits which broadly offset the negative effect on future variable annuity fee income. The overall negative effect of £144 million principally reflects the prudent decision taken by Jackson to increase the allowance for future credit defaults following the widening of credit spreads in the second half of 2011.

Effective tax rates

The effective rate of tax on operating profit based on longer-term investment returns was 26 per cent (2010: 23 per cent). For 2010, adjusting the reported tax rate to exclude the exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities, the underlying tax rate on 2010 operating profits was 27 per cent.

The effective rate of tax at the total EEV profit level was 27 per cent (2010: 17 per cent). Adjusting the rate in 2010 to exclude the exceptional tax credit of £158 million gives an underlying tax rate at the total profit level of 22 per cent.

At the operating profit level, the effective underlying tax rate is lower in 2011 than in 2010, reflecting reduced UK corporation tax rates. At the total profit level, the underlying effective tax rate is higher than in 2010 reflecting the absence of favourable one-off adjustments in the US tax rate, partly offset by reduced UK corporation tax rates.

Earnings and dividends per share

Earnings per share (EPS)

	2011 pence	2010 Excluding exceptional tax credit[(i)] pence	2010 Including exceptional tax credit pence
Basic EPS based on operating profit after tax and non-controlling interests			
IFRS	63.9	62.0	68.3
EEV	115.7	106.9	113.2
Basic EPS based on total profit after non-controlling interests			
IFRS	58.8		56.7
EEV	84.6		101.9

Note
(i) The exceptional tax credit in 2010 relates to a £158 million credit which primarily relates to the impact of a settlement agreed with the UK tax authorities.

Dividend per share

Interim dividends are recorded in the period in which they are paid. Final dividends are recorded in the period in which they are approved by shareholders. The final dividend for the year ended 31 December 2010 of 17.24 pence per ordinary share was paid to eligible shareholders on 26 May 2011 and the 2011 interim dividend of 7.95 pence per ordinary share was paid to eligible shareholders on 22 September 2011.

In light of the continued strong performance of the business and the Group's focus on a growing dividend, the Board has recommended a final dividend of 17.24 pence per share (2010: 17.24 pence), giving a full 2011 dividend of 25.19 pence (2010: 23.85 pence), representing an increase of 5.6 per cent over 2010.

The 2011 final dividend of 17.24 pence per ordinary share will be paid on 24 May 2012 in sterling to shareholders on the principal register and the Irish branch register at 6.00 pm BST on Friday, 30 March 2012 (the 'Record Date'), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30 pm Hong Kong time on the Record Date (HK Shareholders). Holders of US American Depositary Receipts (US Shareholders) will be paid their dividends in US dollars on or about five days after the payment date of the dividend to shareholders on the principal register. The final dividend will be paid on or about 31 May 2012 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte.) Limited (CDP) at 5.00 pm Singapore time on the Record Date (SG Shareholders). The dividend payable to the HK Shareholders will be translated using the exchange rate quoted by the WM Company at the close of business on 12 March 2012. The exchange rate at which the dividend payable to the SG Shareholders will be translated into SG$ will be determined by CDP. The dividend will distribute an estimated £439 million of shareholders' funds.

In line with 2010, shareholders on the principal register and Irish branch register will be able to participate in a Dividend Reinvestment Plan.

The Board will maintain its focus on delivering a growing dividend, which will continue to be determined after taking into account our Group's financial flexibility and our assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium-term a dividend cover of around two times is appropriate.

Financial review

Movement on shareholders' funds

	IFRS		EEV	
	2011 £m	2010 AER £m	2011 £m	2010 AER £m
Operating profit based on longer-term investment returns	2,070	1,941	3,978	3,696
Items excluded from operating profit	(127)	(480)	(1,056)	(589)
Total profit before tax	1,943	1,461	2,922	3,107
Exceptional tax credit	–	158	–	158
Tax and non-controlling interests	(453)	(188)	(780)	(692)
Profit for the period	1,490	1,431	2,142	2,573
Exchange movements, net of related tax	(100)	251	(158)	693
Unrealised gains and losses on Jackson securities classified as available-for-sale[a]	312	478	–	–
Dividends	(642)	(511)	(642)	(511)
New share capital subscribed	17	75	17	75
Other	9	36	71	104
Net increase in shareholders' funds	1,086	1,760	1,430	2,934
Shareholders' funds at beginning of year	8,031	6,271	18,207	15,273
Shareholders' funds at end of year	9,117	8,031	19,637	18,207
Comprising:				
Long-term business				
Free surplus[b]			2,839	2,748
Required capital			3,447	3,415
Net worth[c]			6,286	6,163
Value of in-force			13,364	12,051
Total			19,650	18,214
Other business[d]			(13)	(7)
Total[e]			19,637	18,207

Notes

(a) Net of related changes to deferred acquisition costs and tax.

(b) The increase in free surplus of £91 million from 31 December 2010 arises primarily from £1,100 million being generated by the long-term business (net of new business investment and market related movements), less the cash paid to the holding company, market movements, and other items.

(c) The increase in net worth in the period principally reflects the free surplus generated in the period, offset by cash paid to the holding company, changes to required capital and other items.

(d) Shareholders' funds for other than long-term business comprises:

	2011 £m	2010 £m
Asset management operations(i)	1,783	1,787
Holding company net borrowings	(2,188)	(2,212)
Other, net	392	418
Total shareholders' funds for other business	(13)	(7)

Note

(i) Including goodwill of £1,230 million for 31 December 2011 and 2010.

(e) EEV shareholders' funds excluding goodwill attributable to shareholders at 31 December 2011 is £18,172 million (2010: £16,741 million).

IFRS

Statutory IFRS basis shareholders' funds at 31 December 2011 were £9.1 billion. This compares to £8.0 billion at 31 December 2010 and represents an increase of £1.1 billion, equivalent to 14 per cent.

The movement primarily reflects the profit for the period after tax and non-controlling interests of £1,490 million and the increase in the level of net unrealised gains on Jackson's debt securities of £312 million from the position at 31 December 2010, offset by the payment of dividends of £642 million and exchange translation losses of £100 million.

EEV

On an EEV basis, which recognises the shareholders' interest in long-term business, shareholders' funds at 31 December 2011 were £19.6 billion, an increase of £1.4 billion from the 31 December 2010 level, equivalent to 8 per cent. This increased level of shareholders' funds primarily reflects the profit after tax of £2,142 million, offset by the negative effects of exchange movements of £158 million and dividend payments of £642 million.

The shareholders' funds at 31 December 2011 relating to long-term business of £19.7 billion comprise £8.5 billion (up 15 per cent from year end 2010) for our Asian long-term business operations, £5.1 billion (up 6 per cent from year end 2010) for our US long-term business operations and £6.1 billion (up 1 per cent from year end 2010) for our UK long-term business operations.

At 31 December 2011, the embedded value for our Asian long-term business operations was £8.5 billion, with £7.1 billion (up £1.1 billion from 2010) being in the South East Asia countries of Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam together with Hong Kong. For Prudential's other Asian markets, the embedded value was £1.4 billion in aggregate, unchanged from 2010.

Financial review

Free surplus and holding company cash flow

The total movement in free surplus net of tax in the year can be analysed as follows:

	2011 £m	2010 £m
Free surplus generation		
Expected in-force cash flows (including expected return on net assets)	2,335	2,139
Life operations	1,972	1,829
Asset management operations	363	310
Changes in operating assumptions and experience variances	168	220
RPI to CPI inflation measure change on defined benefit pension schemes(i)	33	–
Underlying free surplus generated in the period from in-force business	2,536	2,359
Investment in new business	(553)	(645)
Underlying free surplus generated in the period	1,983	1,714
Market related items	(531)	(94)
Free surplus generated in the period from retained businesses	1,452	1,620
Net cash remitted by the business units	(1,105)	(935)
Other movements and timing differences	(264)	122
Total movement during the period	83	807
Free surplus at 1 January	3,338	2,531
Free surplus at end of period	3,421	3,338
Comprised of:		
Free surplus relating to long-term insurance business	2,839	2,748
Free surplus of other insurance business	29	33
IFRS net assets of asset management businesses excluding goodwill	553	557
Total free surplus	3,421	3,338

Note
(i) During the first half of 2011 the Group altered its assumptions for future statutory increases to pension payments for its UK defined benefit pension schemes. This reflects the UK government's decision to change the basis of indexation from RPI to CPI.

Free surplus and holding company cash flow continued

Overview

The Group manages its internal cash flow by focusing on the free surplus generated by the life and asset management businesses. Remittances are, however, made as and when required by the holding company, with excess surplus being left in the businesses where it can be redeployed most profitably. The tables below set out the Group's free surplus generation, and the holding company cash flow statement for 2011.

Free surplus generation

Sources and uses of free surplus generation from the Group's insurance and asset management operations

Group free surplus at the end of the period comprises free surplus for the insurance businesses, representing the excess of the net worth over the required capital included in the EEV results, and IFRS net assets for the asset management businesses excluding goodwill. The free surplus generated during the period comprises the movement in this balance excluding foreign exchange, capital movements, and other reserve movements. Specifically, it includes amounts maturing from the in-force operations during the period less the investment in new business, the effect of market movements and other items.

For asset management operations we have defined free surplus generation to be total post-tax IFRS profit for the period. Group free surplus generated also includes the general insurance commission earned during the period and excludes shareholders' other income and expenditure, and centrally arising restructuring and Solvency II implementation costs.

During 2011 Prudential generated total free surplus from the retained businesses of £1,452 million (2010: £1,620 million). Underlying free surplus generated from the in-force book in 2011 increased by 8 per cent to £2,536 million (2010: £2,359 million), as a result of increased expected returns from the growing insurance book. Changes in operating assumptions and variances comprise £168 million for our life business (2010: £220 million) and a £33 million credit arising from a reduction in the liabilities of the Group's defined benefit pension schemes following the UK government's decision to change the basis of indexation from RPI to CPI. The life business variances comprise positive £52 million in Asia (2010: positive £3 million), negative £38 million in the UK (2010: positive £26 million), and positive £154 million in the US (2010: positive £191 million), principally reflecting favourable spread experience.

Underlying free surplus generated from in-force business has been used by our life businesses to invest in new business. Despite the strong growth in APE sales, investment in new business[1] has fallen by 14 per cent to £553 million in 2011 as a result of improved capital efficiency. This compares to a 6 per cent increase in sales[1] and a 6 per cent increase in new business profits[1]. The strong improvement in capital efficiency is primarily the result of continuing the active management of the product and geographical mix of the new business sold, in line with the Group's disciplined approach to capital conservation and value optimisation.

Market-related movements of negative £531 million in 2011 (2010: negative £94 million) include negative £432 million from the US, principally reflecting the adverse impact on free surplus of the equity volatility experienced in 2011. It also includes negative £49 million in Asia, in part reflecting a fall in equity markets in Taiwan, negative £26 million in the UK and negative £24 million from our asset management businesses.

Note

1 Excludes Japan which ceased writing new business in 2010. Investment in business in Japan in 2011 was £nil (2010: £2 million).

Financial review

Value created through investment in new business by life operations

2011 £m

	Asian operations						
	Excluding Japan	Japan	Total	US insurance operations	UK insurance operations	Group Total excluding Japan	Group Total including Japan
Free surplus invested in new business	(297)	–	(297)	(202)	(54)	(553)	(553)
Increase in required capital	97	–	97	232	77	406	406
Net worth invested in new business	(200)	–	(200)	30	23	(147)	(147)
Value of in-force created by new business	1,011	–	1,011	500	172	1,683	1,683
Post-tax new business profit for the year	811	–	811	530	195	1,536	1,536
Tax	265	–	265	285	65	615	615
Pre-tax new business profit for the year	1,076	–	1,076	815	260	2,151	2,151
New business sales (APE)	1,660		1,660	1,275	746		
New business margins (% APE)	65%		65%	64%	35%		
Internal rate of return*	>20%		>20%	>20%	>20%		

AER

2010 £m

	Asian operations						
	Excluding Japan	Japan	Total	US insurance operations	UK insurance operations	Group Total excluding Japan	Group Total including Japan
Free surplus invested in new business	(278)	(2)	(280)	(300)	(65)	(643)	(645)
Increase in required capital	84	–	84	270	107	461	461
Net worth invested in new business	(194)	(2)	(196)	(30)	42	(182)	(184)
Value of in-force created by new business	866	1	867	525	224	1,615	1,616
Post-tax new business profit for the year	672	(1)	671	495	266	1,433	1,432
Tax	230	–	230	266	99	595	595
Pre-tax new business profit for the year	902	(1)	901	761	365	2,028	2,027
New business sales (APE)	1,501		1,508	1,164	820		
New business margins (% APE)	60%		60%	65%	45%		
Internal rate of return*	>20%		>20%	>20%	>20%		

* The internal rate of return (IRR) is equivalent to the discount rate at which the present value of the post-tax cash flows expected to be earned over the lifetime of the business written in shareholder-backed life funds is equal to the total invested capital to support the writing of the business. The capital included in the calculation of the IRR is equal to the amount required to pay acquisition costs and set up statutory reserves less premiums received, plus encumbered capital. The impact of the time value of options and guarantees is included in the calculation.

Value created through investment in new business by life operations continued

	CER						
	2010 £m						
	Asian operations						
	Excluding Japan	Japan	Total	US insurance operations	UK insurance operations	Group Total excluding Japan	Group Total including Japan
Free surplus invested in new business	(275)	(2)	(277)	(288)	(65)	(628)	(630)
Increase in required capital	84	–	84	260	107	451	451
Net worth invested in new business	(191)	(2)	(193)	(28)	42	(177)	(179)
Value of in-force created by new business	862	1	863	505	224	1,591	1,592
Post-tax new business profit for the year	671	(1)	670	477	266	1,414	1,413
Tax	229	–	229	257	99	585	585
Pre-tax new business profit for the year	900	(1)	899	734	365	1,999	1,998
New business sales (APE)	1,491		1,491	1,121	820		
New business margins (% APE)	60%		60%	65%	45%		
Internal rate of return*	>20%		>20%	>20%	>20%		

* The internal rate of return (IRR) is equivalent to the discount rate at which the present value of the post-tax cash flows expected to be earned over the lifetime of the business written in shareholder-backed life funds is equal to the total invested capital to support the writing of the business. The capital included in the calculation of the IRR is equal to the amount required to pay acquisition costs and set up statutory reserves less premiums received, plus encumbered capital. The impact of the time value of options and guarantees is included in the calculation.

Overall, the Group wrote £3,681 million of sales on an APE basis in 2011 (2010: £3,485 million[1]) generating a post-tax new business contribution to embedded value of £1,536 million (2010: £1,433 million[1]). To support these sales, we invested £553 million of capital (2010: £643 million[1]). By focusing on sales of products and in geographies which are less capital intensive, the Group has increased the amount of post-tax new business profit contribution to embedded value per £1 million of free surplus invested by 27 per cent to £2.8 million (2010: £2.2 million). We estimate the Group's overall internal rate of return for the year ended 31 December 2011 to be greater than 20 per cent. The amount of capital invested covers both new business strain, including commissions, of £147 million (2010: £182 million[1]) and the required capital of £406 million (2010: £461 million[1]). Management will continue to focus on capital preservation and investment in those areas which add most value to the Group.

In Asia, investment in new business was £297 million, a 7 per cent increase over the £278 million[1] invested in 2010. This contrasts to an 11 per cent increase in new business sales (APE) in the period. For each £1 million of free surplus invested we generated £2.7 million of post-tax new business contribution to embedded value (2010: £2.4 million), the improvement being driven by geographic and product mix changes. The average free surplus undiscounted payback period for business written in 2011 was three years (2010: three years).

In the US, investment in new business was £202 million, 33 per cent lower than 2010 (£300 million) and contrasts to a 10 per cent increase in APE new business sales. For each £1 million of free surplus invested we generated £2.6 million of post-tax new business contribution to embedded value (2010: £1.7 million). This higher return reflects both a higher proportion of variable annuity business being sold in the year, with a reduced proportion of more capital intensive fixed annuities, product changes which reduce the reserving requirements and marketing cost efficiency. The average free surplus undiscounted payback period for business written in 2011 was one year (2010: one year).

In the UK, investment in new business was lower, at £54 million compared to £65 million last year. This investment generated APE sales which were 9 per cent lower at £746 million in 2011. For each £1 million of free surplus invested we generated £3.6 million of post-tax new business contribution to embedded value (2010: £4.1 million), with 2010 benefiting from the relatively low capital utilisation of the profitable bulk annuity business written in the last quarter of 2010. The average free surplus undiscounted payback period for shareholder-backed business written in 2011 was four years (2010: four years).

Note
1 Excludes Japan which ceased writing new business in 2010.

Financial review

Holding company cash flow

	2011 £m	2010 £m
Net cash remitted by business units:		
UK Life fund paid to the Group	223	202
Shareholder-backed business:		
Other UK paid to the Group	116	275
Group invested in UK	(42)	(57)
Total shareholder-backed business	74	218
UK net	297	420
US paid to the Group	322	80
Group invested in US	–	–
US net	322	80
Asia paid to the Group		
Long-term business	289	330
Other operations	55	33
	344	363
Group invested in Asia		
Long-term business	(50)	(63)
Other operations	(88)	(67)
	(138)	(130)
Asia net	206	233
M&G paid to the Group	213	150
PruCap paid to the Group	67	52
Net remittances to the Group from business units	1,105	935
Net interest paid	(282)	(231)
Tax received	181	185
Corporate activities	(139)	(146)
Solvency II costs	(56)	(34)
Total central outflows	(296)	(226)
Operating holding company* cash flow before dividend	809	709
Dividend paid (net of scrip in respect of 2010)	(642)	(449)
Operating holding company* cash flow after dividend	167	260
Issue of hybrid debt, net of costs	340	–
Repayment of subordinated debt	(333)	–
Costs of terminated AIA transaction	–	(377)
Bank loan reorganisation	–	120
Other cash payments	(205)	(276)
Total holding company cash flow	(31)	(273)
Cash and short-term investments at beginning of period	1,232	1,486
Foreign exchange movements	(1)	19
Cash and short-term investments at end of period	1,200	1,232

* Including central finance subsidiaries.

Holding company cash flow

We continue to manage cash flows across the Group with a view to achieving a balance between ensuring sufficient net remittances from the businesses to cover the progressive dividend (after corporate costs) and maximising value for shareholders through the retention of the free surplus generated at business unit level, so that it can be reinvested in the profitable opportunities available to the Group. On this basis, the holding company cash flow statement at an operating level should ordinarily balance close to zero before exceptional cash flows, but, from time to time, additional remittances from business operations will be made to provide the Group with greater financial flexibility at the corporate centre.

Operating holding company cash flow for 2011 before the shareholder dividend was £809 million, £100 million higher than 2010. After deducting the higher level of shareholder dividend paid following the upward rebasing at the end of 2010 and the cancellation of the scrip dividend option, the operating holding company cash flow was positive £167 million (2010: £260 million).

Cash remittances to the Group from business units

As previously highlighted, the Group focuses on the generation of free surplus by each of the Group's business units and then determines the use of this surplus, balancing between financing new business growth, retaining surplus capital in operations to absorb the effect of market shocks and remitting funds to the Group to cover central outgoings, including the shareholder dividend.

The holding company received £1,105 million of net cash remittances from the business units in 2011, an increase of £170 million from 2010.

Asia continues to be cash positive, with its remittances to the Group during 2011 at £206 million (2010: £233 million). 2010 benefited from a one-off remittance of £130 million from Malaysia, representing the accumulation of historic distributable reserves. Excluding this amount Asia has doubled its net remittances in 2011. Asia remains on track to meet its objective of £300 million net remittances in 2013.

Cash received from Jackson was £322 million in 2011 (2010: £80 million), above the 2013 sustainable remittance target of £200 million. Jackson's remittance to the Group for 2011 was taken in the first half, with £200 million representing the remittances for the year and a further £122 million representing releases of excess surplus to Group. These exceptional releases reflect the success that Jackson has enjoyed in rebuilding its balance sheet strength post the 2008 financial crisis and in writing business at high internal rates of return (IRRs) and with fast payback.

The UK insurance operations remitted £297 million in 2011 (2010: £420 million). Total shareholder-backed business net remittances in 2011 were £74 million (2010: £218 million) with 2010 including £120 million as a result of one-off release of surplus and net financing payments during that year. Cash from the annual with-profits transfer to shareholders increased from £202 million to £223 million in 2011. The UK remains on track to deliver £350 million of cash to the Group in 2013.

The Group's UK asset management operations remit substantially all of their annual post-tax earnings to the Group. M&G and PruCap collectively remitted £280 million (2010: £202 million).

In the course of 2009 and 2010, the Group raised certain financing contingent on future profits of the UK and Hong Kong life insurance operations which increased the cash remitted by business units by £245 million in aggregate. This was done in order to increase the financial flexibility of the Group during the investment market crisis.

Since then principal and interest repayments have reduced the cash available to be remitted to the Group by these businesses. Based on our current plans, the remaining balance of £145 million will impact the net remittances from these businesses in 2012.

Central outflows and other movements

Central outflows increased to £296 million in 2011 (2010: £226 million). Lower corporate activities spend in 2011 was offset by increased net interest payments, following the additional debt raised in 2011, and higher Solvency II implementation spend as we draw closer to the date that this regime comes into effect.

After central costs, there was a net cash inflow before dividend of £809 million in 2011 compared to £709 million for 2010. The dividend paid was £642 million in 2011, compared to £449 million (net of scrip of £62 million) in 2010.

During the first half of 2011 we raised £340 million, net of costs, from the issue of new subordinated debt. Substantially all of these proceeds (£333 million) were used to repay the €500 million Tier 2 subordinated debt in December 2011.

Outside of the normal recurring central cash flow items we incurred £205 million of other cash payments in 2011. These comprise the first instalment to the UK tax authorities following the settlement reached last year on historic tax issues and the prepayment of fees in relation to new distribution agreements in Asia. A further amount relating to the settlement with the UK tax authorities of £135 million will be paid evenly over the course of 2012 and 2013.

The overall holding company cash and short-term investment balances at 31 December 2011 was broadly level with the balance held at the end of 2010 at £1.2 billion. The company seeks to maintain a central cash balance in excess of £1 billion.

Financial review

Balance sheet

Summary

	AER	
	2011 £m	**2010** £m
Goodwill attributable to shareholders	1,465	1,466
Investments	250,605	239,297
Holding company cash and short-term investments	1,200	1,232
Other	20,310	18,811
Total assets	273,580	260,806
Less: Liabilities		
Policyholder liabilities	227,075	214,727
Unallocated surplus of with-profits funds	9,215	10,253
	236,290	224,980
Less: Shareholders' accrued interest in the long-term business	(10,520)	(10,176)
	225,770	214,804
Core structural borrowings of shareholders' financed operations (IFRS book value basis)	3,611	3,676
Other liabilities including non-controlling interest	24,562	24,119
Total liabilities and non-controlling interest	253,943	242,599
EEV basis net assets	19,637	18,207
Share capital and premium	2,000	1,983
IFRS basis shareholders' reserves	7,117	6,048
IFRS basis shareholders' equity	9,117	8,031
Additional EEV basis retained profit	10,520	10,176
EEV basis shareholders' equity (excluding non-controlling interest)	19,637	18,207

Financial instruments

The Group is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The key financial risk factors that affect the Group include market risk, credit risk and liquidity risk. Information on the Group's exposure to financial risk factors, and our financial risk management objectives and policies, is provided both in the Risk and Capital Management section and the financial statements. Further information on the sensitivity of the Group's financial instruments to market risk and its use of derivatives is also provided in the financial statements.

The Group's investments are discussed in further detail in the Risk and Capital Management section B.1.b 'Credit risk'.

Policyholder liabilities and unallocated surplus of with-profits fund

	AER				
	2011 £m				2010 £m
Shareholder-backed business	Asia	US	UK	Total	Total
At 1 January	17,716	60,523	43,944	122,183	100,061
Premiums	3,807	12,914	3,575	20,296	19,584
Surrenders	(1,735)	(4,270)	(1,970)	(7,975)	(6,724)
Maturities/Deaths	(233)	(820)	(2,262)	(3,315)	(3,165)
Net cash flows	1,839	7,824	(657)	9,006	9,695
Investment related items and other movements	(909)	136	2,761	1,988	9,249
Acquisition of UOB Life Assurance Limited	–	–	–	–	464
Dilution of holding in PruHealth	–	–	–	–	(27)
Foreign exchange translation difference	(377)	706	–	329	2,741
At 31 December	18,269	69,189	46,048	133,506	122,183
With-profits funds					
Policyholder liabilities				93,569	92,544
Unallocated surplus				9,215	10,253
Total at 31 December				102,784	102,797
Total policyholder liabilities including unallocated surplus at 31 December				236,290	224,980

Policyholder liabilities and unallocated surplus of with-profits fund

Policyholder liabilities related to shareholder-backed business grew by £11.3 billion from £122.2 billion at 31 December 2010 to £133.5 billion at 31 December 2011.

The increase reflects positive net flows (premiums less surrenders and maturities/deaths) of £9,006 million in 2011 (2010: £9,695 million), driven by strong inflows in the US (£7,824 million) and Asia (£1,839 million). Net flows in Asia have increased by 42 per cent to £1,839 million in 2011 (2010: £1,298 million). Additionally, the rate of surrenders in Asia (expressed as a percentage of opening liabilities) was 4.4 per cent in the second half of 2011, an improvement compared with 5.1 per cent in the first half of 2011 and 6.4 per cent in the second half of 2010. The overall rate of surrender in 2011 was 9.8 per cent compared with 13.8 per cent in 2010.

Other movements include positive foreign exchange movements of £329 million (2010: £2,741 million) together with investment related and other items of £1,988 million. Investment related and other items fell from £9,249 million in 2010 to £1,988 million in 2011 principally as a result of the weaker equity markets.

During 2011, the unallocated surplus, which represents the excess of assets over policyholder liabilities for the Group's with-profits funds on an IFRS basis, reduced by 10 per cent from £10.3 billion at 31 December 2010 to £9.2 billion at 31 December 2011.

Financial review

Shareholders' net borrowings and ratings

Shareholders' net borrowings at 31 December 2011:

	AER					
	2011 £m			2010 £m		
	IFRS basis	Mark to market value	EEV basis	IFRS basis	Mark to market value	EEV basis
Perpetual subordinated						
Capital securities (Innovative Tier 1)	1,823	(10)	1,813	1,463	28	1,491
Subordinated notes (Lower Tier 2)	829	120	949	1,255	117	1,372
	2,652	110	2,762	2,718	145	2,863
Senior debt						
2023	300	56	356	300	33	333
2029	249	21	270	249	(1)	248
Holding company total	3,201	187	3,388	3,267	177	3,444
Prudential Capital	250	–	250	250	–	250
Jackson surplus notes (Lower Tier 2)	160	17	177	159	13	172
Total	3,611	204	3,815	3,676	190	3,866
Less: Holding company cash and short-term investments	(1,200)	–	(1,200)	(1,232)	–	(1,232)
Net core structural borrowings of shareholder-financed operations	2,411	204	2,615	2,444	190	2,634

Shareholders' net borrowings and ratings

The Group's core structural borrowings at 31 December 2011 totalled £3.6 billion on an IFRS basis, compared with £3.7 billion at 31 December 2010.

In January 2011, the Company issued US$550 million 7.75 per cent Tier 1 subordinated debt, primarily to retail investors. The proceeds, net of costs, were US$539 million (£340 million) and financed the repayment of the €500 million Tier 2 subordinated notes in December 2011.

After adjusting for holding company cash and short-term investments of £1,200 million, net core structural borrowings at 31 December 2011 were £2,411 million compared with £2,444 million at 31 December 2010. The decrease of £33 million represents the net fall in borrowings of £65 million, reflecting the debt repayment and issue described above together with foreign exchange movements in the year, offset by a £32 million fall in holding company cash and short-term investments.

In addition to our core structural borrowings set out above, we also have in place an unlimited global commercial paper programme. As at 31 December 2011, we had issued commercial paper under this programme totalling £736 million, US$2,539 million, €342 million, CHF62 million and AU$12 million. The central treasury function also manages our £5 billion medium-term note (MTN) programme, covering both core and non-core borrowings. In April and October 2011 we refinanced an existing internal £200 million issue under this programme. In total, at 31 December 2011 the outstanding subordinated debt under the programme was £835 million, US$1,300 million and €20 million, while the senior debt outstanding was £550 million. In addition, our holding company has access to £2.1 billion of syndicated and bilateral committed revolving credit facilities, provided by 17 major international banks, expiring between 2013 and 2017. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 31 December 2011. The commercial paper programme, the MTN programme and the committed revolving credit facilities are all available for general corporate purposes and to support the liquidity needs of our holding company and are intended to maintain a strong and flexible funding capacity.

We manage the Group's core debt within a target level consistent with our current debt ratings. At 31 December 2011, the gearing ratio (debt, net of cash and short-term investments, as a proportion of EEV shareholders' funds plus net debt) was 10.9 per cent, compared with 11.8 per cent at 31 December 2010. Prudential plc has strong debt ratings from Standard & Poor's, Moody's and Fitch. Prudential's long-term senior debt is rated A+, A2 and A from Standard & Poor's, Moody's and Fitch, while short-term ratings are A-1, P-1 and F1 respectively.

The financial strength of PAC is rated AA by Standard & Poor's, Aa2 by Moody's and AA by Fitch.

Jackson National Life Insurance Company's financial strength is rated AA by Standard & Poor's, A1 by Moody's and AA by Fitch.

Financial position on defined benefit pension schemes

The Group currently operates three defined benefit schemes in the UK, of which by far the largest is the Prudential Staff Pension Scheme (PSPS) and two smaller schemes, Scottish Amicable (SAPS) and M&G.

Defined benefit schemes in the UK are generally required to be subject to a full actuarial valuation every three years, in order to assess the appropriate level of funding for schemes in relation to their commitments. The last completed actuarial valuation of PSPS was as at 5 April 2008, demonstrating the scheme to be 106 per cent funded, but additional funding akin to deficit funding was agreed by the Trustees in recognition of the fall in value of the scheme's investments between 5 April 2008 and the completion of the valuation in 2009. This additional deficit funding is apportioned in the ratio of 70/30 between the PAC with-profits fund and shareholder-backed operations, reflecting the company's historic rate of contributions over many years. The total contributions being currently made by the Group into the scheme, representing the annual accrual cost and deficit funding, are £50 million per annum. This amount will continue until the next valuation as at 5 April 2011 is finalised later in 2012 and the future level of company contributions is agreed with the Trustees. The valuation basis under IAS 19 for the Group financial statements differs markedly from the full triennial actuarial valuation basis. In particular, for PSPS, where constraints in the trust deed prevent the Group access to any surplus in the scheme, the IAS 19 surplus, measured on an economic basis net of related tax relief, of £1,391 million at 31 December 2011 (2010: £421 million) is not recognised.

The actuarial valuation of SAPS as at 31 March 2008 demonstrated the scheme to be 91 per cent funded. Based on this valuation and subsequent agreement with the Trustees, £13.1 million per annum of deficit funding is currently being paid into the scheme. The actuarial valuation of SAPS as at 31 March 2011 is currently being finalised.

The actuarial valuation of the M&G pension scheme as at 31 December 2008 demonstrated the scheme to be 76 per cent funded. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a five year period have been agreed with £14.1 million being paid in each of 2010 and 2011 and £9.3 million per annum for the subsequent three years. In 2011, the Group agreed with the Trustee to pay an additional funding of £1.2 million per annum from January 2012 until the conclusion of the actuarial valuation as at 31 December 2011, which is currently in progress.

As at 31 December 2011, on the Group IFRS statement of financial position, the shareholders' share of the net liabilities for these UK schemes amounted to a £17 million liability net of related tax relief (2010: £83 million). The total share attributable to the PAC with-profits fund amounted to a liability of £38 million net of related tax relief (2010: £99 million). The adoption by the Group in 2011 of the UK government's decision to use the CPI in place of the RPI as the basis for inflationary increases to pensions, affected the IAS 19 valuation of certain tranches of the Group's schemes. This resulted in a credit to pre-tax IFRS operating profit of £42 million. The impact of this change on the shareholders' share of pension liabilities, net of related tax relief and the total share attributable to the PAC with-profits fund, net of related tax relief, was a reduction of £31 million and £22 million, respectively.

Financial strength of the UK Long-term fund

On a realistic valuation basis, with liabilities recorded on a market consistent basis, the free assets were valued at approximately £6.1 billion at 31 December 2011, before a deduction for the risk capital margin. The value of the shareholders' interest in future transfers from the UK with-profits fund is estimated at £2.0 billion. The financial strength of PAC is rated AA by Standard & Poor's, Aa2 by Moody's and AA by Fitch Ratings.

Despite the decline in financial markets during 2011, Prudential UK's with-profits fund performed relatively strongly achieving a 2.1 per cent pre-tax investment return for policyholder asset shares during 2011.